Software Rights Archive, LLC v. Google Inc. et al Doc. 189

EXHIBIT 1

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UNITED STATES DISTRICT COURT FOR THE

NORTHERN DISTRICT OF CALIFORNIA

SAN JOSE DIVISION

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THE APPLE iPOD iTUNES ANTI-TRUST LITIGATION, No. C-050037-JW(RS)

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DEPOSITION OF ROGER G. NOLL, Ph.D.

Taken before EARLY K. LANGLEY, RPR, RMR

CSR No. 3537

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Q. And at what point did you think this case, as it was described to you, sounded a lot like Microsoft?

A. Instantaneously.

Q. And what was it about the description of 10:20 this case that led you to that initial reaction?

A. We were talking about the tying aspect of it, and that's what sounded like it was -- had a similarity to tying middleware to operating systems that were parts of numerous complaints 10:20 against Microsoft.

Q. Do you have any information one way or another whether a consumer can play music from the iTune store on any portable digital player other than iPod? 10:21

A. Well, I'm -- yeah, I'm aware precisely what their limitations are. I mean, if you -- the mechanism is to either do an actual or virtual burn of the CD and then replay it.

Q. And in that way, music can be played from 10:21 the iTunes store on portable players other than an iPod; correct?

A. If you go through that set of procedures, yes. Just like you could always use Netscape, even though Internet Explorer was the default sometimes the first person in line buys it for whatever the retail price is and resells it on eBay that day for two or three times while -- what that person paid for it.

So the nature of consumer demand is that some people have a high willingness to pay, some people have a medium willingness to pay, some people have a low willingness to pay. The issue is what is the actual market price and how did that market price come about. 10:25 10:26

Q. Do you -- does it matter to your opinion on the economics of this case whether a consumer purchased an iPod based on that consumer's evaluation of iPods versus competing products, without regard to the availability of music from Apple's music store? 10:26

A. What is the -- what is essential for this case to have any merit on the tying side has to do with whether there is a substantial effect on the demand for and price of iPods. 10:26

* And so the identity of a particular consumer with respect to whether their objective was getting access to digital downloads, on a portable digital player is not what's relevant. * What's relevant is were there enough people in the 10:27

market who wanted to use it for that purpose such that the tie enabled a firm with market power in digital downloads to transfer that market power to the portable digital media player and thereby succeed in raising price in that second market and 10:27 did it, in fact, increase the demand for that particular product because of its unique ability to download things from the iTunes Music Store.

Q. Is that a "no" to the question?

A. Well, it's an explanation because it, you 10:27 know, "yes" or "no" doesn't -- I mean, you asked a question about the specific consumers, and it's markets that matter, not specific consumers.

So it has to be some consumers out there bought it for the purpose of digital downloads. 10:28 It doesn't have to be all and I don't have to identify some specific customer who bought it for that purpose.

* What's necessary is that it shifted the demand curve outward for iPods to have it be the 10:28 only one that could access iTMS. So it's something that the market level, not the individual -- the demand curve outward because of its unique ability to access the iTunes Music Store. *

Q. Okay. And what is the "it" there when you say it shifted --
A. The fact that there was a differential ease of access that it was substantial between iPods and competing portable digital media players. 10:28
Q. Okay. And that differential ease of access is the two extra steps, burning and ripping; correct?
* A. The issue with -- yes. The issue is the question -- the core question is whether that is substantial enough to -- to be the equivalent of a small but significant nontransitory increase in price. That is to say, does it impose a cost that is sufficient so that it affects peoples' decisions about which portable digital media player to buy. * 10:28 10:29
Q. Okay. And, again, the "it" in that answer is the two extra steps to get music from Apple's music store to a competing player as opposed to an iPod; is that correct? 10:29
A. There's that aspect to it, plus there's also a potential issue about the quality of reproduction arising from undertaking those steps.
Q. Okay. Do you hold the view that that type 10:29

* The issue is not would they have market power. The issue is not does all of their market power derive from the tie. The issue is is there a not insubstantial part of that market power that is derived from the tie. * 11:25

So, the fact that the defendant believes, and I'm certainly willing to accept believes honestly, that their product is the best product isn't the relevant issue.

The relevant issue is in the absence of 11:26 the tie would they have made the same sales at the same price or would there have been a difference. *

* Q. And by "the tie," you're referring to what you called earlier the differential ease of access? 11:26

A. I'm referring -- well, I'm -- that's your version of it.

My version of it is by the exclusive -- exclusivity of the FairPlay Digital Rights Management system which is a dual decision, 11:26 decision not to use any other Digital Rights Management system and a decision not to license FairPlay. #

Q. Okay. And as you look at the result or the consequences of those, that dual decision, the 11:26

case, then the total monopoly profits go up, if you can engage in tying.

* Q. Okay. Have you made any analysis of the impact of the alleged tying arrangement on the price of music? The price of iTunes music? 14:24

A. I have done no analysis of the effects of the alleged tying. I don't have a merits conclusion. So I -- I haven't done it for the tied product or the tying product, though. This is not the liability phase. This is the class certification phase. 14:24

Q. Is it --

A. I don't have a conclusion about what the effects on the price of anything were.

Q. Okay. Is it plausible that if the plaintiffs were right that there was a tying arrangement, it would have caused the price of iTunes store music to drop? 14:24

A. Maybe, maybe not.

Q. Compared to the but-for world? 14:25

A. There's -- you can't -- you cannot -- there's no theoretic answer to that question. It's an empirical question. Maybe, maybe not. It depends.

Q. It depends on the results of a regression 14:25

analysis taken into account the factors that affect demand for iTunes music?

A. Well, I would have said that's an example of one way to answer the problem, yes. But it -- that's not -- the "it depends" part is it depends on the conditions in the market, the circumstances in the market. 14:25

Q. Okay.

A. Both technical circumstances of production and demand circumstances. 14:25

Q. Okay. Can you describe what circumstances in the market would lead to a lowering of the price of the -- of iTunes music as a result of the alleged tie?

A. The closer the two products are to having a fixed quantitative relationship in terms of the quantity purchased of each. 14:26

Q. Can you give me an example on the other side other than the converse of that?

A. Well, in the case of -- the reason -- it's sort of facetious because obviously this isn't that case. I mean, people typically have an iPod, and then they vary in the number of tunes they buy. All right. So, the -- in this -- it's obviously not a fixed relationship between the 14:26 14:26

complements.

The -- an example of something that is a fixed relationship would be you had to have a personal computer. Right. And one personal computer produces an iPod. Right. Something to interact with an iPod. So that's closer. It isn't complete because someone might have two or three PCs, but that's closer to being. And then even closer still would be the memory in an iPod is in a fixed relationship to the iPod or the microprocessor is in a fixed relationship to the iPod.

Q. Okay. Other than the fixed-relationship concept, what would be another circumstance in the market that would lead theoretically to the conclusion that the price of the tying product, the music, would be lowered as a result of an actual tie?

A. Well, the -- the cost of the substitute for the tied -- the tying product and the tied product.

I mean, had you asked me about at length there's an alternative to iTMS called going out and buying a CD and ripping it. And that's -- that puts a ceiling on whatever iTMS could ever charge for digital, permanent digital downloads.

Q. Okay. So how would that have an effect on whether the price of the tying product, the music, is lowered as a result of the tie if there were a tie? 14:28

A. Well, in principle, if I make a bunch of other assumptions, that produces a world in which iTMS faces a kinked demand curve.

Q. Kinked?

A. Were -- Yeah. K-i-n-k-e-d. 14:28

Q. Demand curve.

A. It's elastic that prices represent the cost of the alternative source and it's inelastic at prices below that in which case they'd always be pricing it to kink no matter what. 14:28

Q. What other conditions are necessary?

A. You don't mean "necessary." What other conditions would lead to there being no effect?

Q. Better question.

A. Well, there's another issue about what's 14:29 called exploitation of the installed base, which is getting a large installed base out there at the -- at -- in a world in which you have the, quote, "low introductory price," unquote, of iTMS. And then after the installed base is there raising the 14:29

price. That would be a whole different world.*

Q. Okay. Your report says that the price difference between two iPod models is twice the difference in the cost of the memory and that the memory, difference in size of memory, is the only difference between the two models. 14:30

Do you remember that, generally?

A. I remember reporting that's what somebody else found in their analysis.

Q. Okay. Can you tell from that comparison of price and cost difference whether Apple has any market power? 14:30

A. Well, as I said earlier, that's -- the reference there is to illustrate the feasibility of a method as contrasted to reach a conclusion. 14:30

All right. And what that paper illustrates is the feasibility of the method of doing a comparative analysis of markups across products based on component analysis.

Now, in order to believe that the result supports that conclusion, you'd have to -- I'd have to have access to the complete data. I mean, the underlying problem with citing that paper for the purpose you described is they weren't using component prices as paid by Apple. They were 14:30 14:31

A. Yeah. Well, in the tying part of the case it's not insignificant or insubstantial. In the rule of reason part, it's more.
Q. Do you agree that the plaintiffs need to show in this case at what point the Music Store 14:39 gained a sufficient market power?
A. I believe they bear the burden of proof that it had market power. What -- I don't know as a legal matter whether they have to state the date, but they certainly have to demonstrate that 14:39 there was a -- was market power in iTMS for some significant period of time, yes.
Q. Okay. And do you have a view on whether that market power was attained by the market -- by the Music Store on day one? 14:39
A. Do I have a view?
As an economic expert, I haven't done the work necessary to prove that one way or the other. My expectation is that if not on day one very early in the process it's likely that they had 14:40 market power in digital, permanent digital downloads just by virtue of the fact there were no close substitutes that had anything like their inventory of products.
Q. Okay. Which is not to say that market 14:40

A. It's how technically literate they are. How easy it is for them to switch the file format, to do the things necessary to switch the file format. Whether they have a CD burner. Not everybody has a CD burner. 15:52

So there are -- the degree to which any given person is locked in is -- just depends on a bunch of stuff.

What's necessary for the lock-in effect to matter is that, indeed, it creates a sufficiently 15:52 less elastic demand curve that there is a small but significant nontransitory increase in price arising from the lock-in effect.

Q. Is another variable in deciding whether a particular person is locked in and buys an iPod 15:52 because of the lock-in rather than a competing player that they prefer the -- the degree to which they prefer the other MP3 player, in other words, the stronger -- the weaker the preference for the other MP3 player, the less they're locked in? 15:53

A. Well, yes. Obviously, how they value the alternatives is relevant.

Q. Is it also --

A. I mean the reality is anybody who bought an iPod, if there was a lock-in effect, anybody 15:53

A. Oh, I'm sorry. I'm sorry. It's late in the day. Explain what we're after now.

Q. You understand that the purported class includes both direct consumers and resellers like Best Buy? 17:01

A. The wholesale market?

Q. Yes.

A. Yes. Remind me what I was asked again.

Q. Do you know whether or not you can use the same regression analyses for both? 17:02

MS. SWEENEY: Both being resellers and consumers?

BY MR. MITTELSTAEDT:

Q. Yes.

* A. My best guess is there's going to be two regression analysis models because obviously the wholesale price differs from the retail price. 17:02

What I -- what I need to know is how the wholesale market actually works. I need documents about Apple's pricing policy in the wholesale market. I need transactions data in the wholesale market and how I'll go about doing it -- doing that part of the analysis would depend on those details. 17:02

Let's take the simplest possible case, 17:02

which I doubt that it's true, but let's assume that it's true. Assume that the wholesale market looks exactly like the retail market, that there's a posted price for each model of iPod that's 30 or 40 percent below the retail price and everybody can buy as much as they want at that posted price. 17:03

In that case, the -- a product-specific dummy variable whether the buyer was a wholesaler would be sufficient, right. But that's almost certainly not going to be true. It might be true. 17:03

But I suspect there are quantity discounts and advance purchase discounts, and, you know, special promotional discounts if you spend some money on advertising we'll pay some of it. So there's likely to be more complexity in the price formation in the wholesale market than in the retail market in which case there will probably have to be two equations. 17:03

Q. And can you tell me anything more than -- more than what is in your report on what the equation will look like for the wholesale -- 17:03

A. Actually, if that's the case, it will look a whole lot like the one I just did which is static random access memory, static random access memory, which is a different kind of case. It's a 17:04

price conspiracy case, but it's still the same basic story, which is that the contracts themselves with the -- the wholesale contracts between the chip manufacturers and the people who make stuff like Apple specifies things like if you promise to buy X in advance so we know what our production run should be, we'll give you a slight discount. 17:04

And if you -- and then there's just straightforward quantity discounts, and there's -- there's other kinds of discounts, so that you have to read the contracts for the large buyers to figure out what the pricing policy is. And now once you've done that, you can just stick some variables in the regression -- the price equation that take into account those contract terms and you can get a price equation. * 17:04 17:05

Q. Okay. Let me turn to one last subject.

If Apple were required to license FairPlay and were permitted to charge a licensing fee, would you expect that that would make music more expensive? 17:05

MS. SWEENEY: Objection. Incomplete hypothetical.

THE WITNESS: Would I expect that that 17:05

integrated system."

A. Right.

MS. SWEENEY: What page?

BY MR. MITTELSTAEDT:

Q. Page 28, second paragraph. 17:19

What does that mean and how can economic analysis determine that?

A. This is -- gets right to the anticompetitive effect story; it's whether there was, quote/unquote, a not insubstantial effect on 17:19 quantity arising from the tie. That's what it means.

The economic analysis focuses on an economic -- a theory-driven economic analysis of the actual market in terms of quantity of output 17:19 of various product versus the but-for market.

And so the -- what economics does is in the end, produce an estimate for you of what the quantitative impact of the anticompetitive restriction was. And a necessary condition for it 17:19 to be more than de minimus is, of course, market power in the tying product market.

* Q. But, this is my problem with that: You say "if a large fraction of customers buy all products from the same vendor." 17:20

A. Right.

Q. You can do an economic analysis and say whether they did it because they preferred all those products or whether they were forced to buy all the products; is that what you are saying? 17:20

A. The act of tying --

Q. By act of tying -- excuse me -- you mean that the seller said I'm not going to sell you product A unless you buy product B?

A. Right. 17:20

Q. So let's say 100 people buy product A and B. And some of them do it because they wanted to, and the others did it because they were forced to against their will. What kind of economic analysis can you do to tell us how many bought 17:21 because they wanted to and how many bought because they were forced to?

A. You don't do it that way. I have answered that before. You don't -- you don't count noses. You determine whether the specific elasticity 17:21 demand for the iPod was made less elastic because of the act of tying.

Q. But you don't know if there was an act of tying. What you're trying to do is figure out was there tying or was there a preference? 17:21

A. You know that an act of tying took place. You don't know if it had caused anticompetitive harm. *

Q. So what you are doing is, again, you're back to the regression where you try and explain away all the price difference you can and then what's left over you say, ah-hah, it must be the tying? 17:21

A. That's right. Only anticompetitive harm is a broader category than just the damages, and it's not the same concept. It's not the same thing. So, you know, the focus in anticompetitive harm is broader and different, but it's the same basic idea, the same basic approach. 17:22

Q. And then finally at page 46, you say, "A strategy of creating lock-in through technical incompatibility is more attractive as the installed base grows." 17:22

Then you talk about the iPod and you say it has an estimated installed base over 110 million users, over 71 million of which have activated iPod for use with Internet downloads. 17:22

A. As of the date, whenever that was.

Q. What do you mean 71 million have activated the iPod for use with Internet downloads? 17:23

70 million and 110 million. She's in the 40 million who have bought an iPod but who are not locked in.

Q. Where does the locked-out number come from? I thought that came from the difference between 110 and 71. That's what I am missing. 17:25

A. No. The locked-out people -- I don't -- you're right. I don't have a firm estimate of that. The locked --

Q. You're doing that by market share? 17:25

A. Yes.

Q. So if Apple has twice the market share of everybody else combined?

A. Yes. It's not quite right. It's not quite right. Because what you have to do is what share of the Apple people have bought from iTMS versus everybody who holds another portable digital player. That's the comparison. 17:26

Q. And, again to -- to -- I think this is clear but to make sure. 17:26

When you say the 71 million, you're not saying they, in fact, are locked in so that when they need to buy another MP3 player they have to buy an iPod?

A. They face a continuum of switching cost 17:26

that hinge on, A, how many files that they still care about are digitally protected that they bought from Apple, how sophisticated are they technically to get around the system, do they own a CD burner. There's a number of factors that go into this. 17:26

Q. All the things we talked about?

A. Yes. So there will be some that are just a little bit locked in and some a lot locked in and some in between. 17:27

Q. And there will be some percentage who go ahead and buy a competing MP3 player because they're not sufficiently locked in; right?

A. In principle that could happen, yes. I am sure there are people out there, although I don't know who they are, that bought an iPod and then subsequently bought something else. But, you know, I don't know what the magnitude of that number is. 17:27

Q. And you can't tell, you don't know? You're now -- 17:27

A. Well --

Q. Just a second. You're not going to figure out and you could care less how many people are in whichever category? 17:27